

The Economic Overview for

2004

Presented to
Tennessee State Funding Board

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I. The National Economy

- Most economic indicators are showing the impact of policies designed to expand the level of economic activity.
- The economic recovery seems to be firmly in place, and the expansion which began in the fourth quarter of 2001 will continue into its third year.
- The solid performance of the economy in 2003, and particularly the increase in Q2 (3.3 percent) and Q3 (8.2 percent), indicates that little or no risk exists of a return to a period of stagnate or negative growth.
- While job growth numbers continue to be disappointing, they have stabilized and should begin to improve as the period of expansion gains maturity.
- However, the dual problem of trade and budget deficits will persist in an environment of weak world economics, outsourced production, and multiple international conflicts.
- Election year infighting will confuse the outlook but not prevent economic expansion from continuing in 2004.
- Job losses in manufacturing remain troubling because of the negative impact they have on the mobility of workers between economic classes.
- Job losses in other cyclically-sensitive industries should begin to disappear as the expansion enters its third year and employers begin to rebuild their production capabilities.
- The one-time impact of federal tax cuts may have been exhausted in 2003, but the tax rate cuts should continue to help the economy expand in 2004.
- Retail sales are rebounding strongly. Nationwide, October 2003 retail sales were up 6.1 percent over those in October 2002. Similarly, August through October 2003 retail sales were up 6.4 percent over those in the same period in 2002 and 5.4 percent overall for January-October.
- Auto sales remain strong with help from low interest rates, growing 6.1 percent over the first ten months of 2003 versus the first ten months of 2002.

- Even with the exclusion of the auto sector, total retail sales grew by 5.3 percent during the first ten months of 2003 versus the same period in 2002.
- Christmas sales are expected to be lower than initially forecast despite increases in consumer confidence.
- Many corporations are beginning to report positive earnings increases, and the stock market is reflecting their optimism.
- In its October 28th meeting, the Federal Reserve Open Market Committee (the Fed) left the Federal Funds Rate unchanged at 1.0 percent. The Fed is still committed to maintaining low interest rates as long as inflation is low and weakness in the job market persists.
- Inflation is just over 2.0 percent annually and is not expected to increase in FY 2005. The ability to increase prices is a reflection of the strength of the economy.
- Personal income continues to grow at a fast rate, 4.0 percent in Q3 versus 3.4 percent in Q2. Income growth, whether earned or unearned, should help consumers pay for their purchases and help the economy avoid rising bankruptcy and loan default rates.
- Pressure on the labor market should continue to grow in the absence of strong job growth in 2004. The natural growth of the labor force, discouraged workers, and additional workers should keep the unemployment rate at nearly 6.0 percent through most of next year.

**Table 1. Unemployment Rates, 2002-2003
(Unadjusted)**

Region	October 2003	October 2002
Memphis	6.0%	5.1%
U.S.	5.6%	5.3%
Tennessee	5.3%	4.7%

*=Unadjusted.

Source: U.S. Bureau of Labor Statistics and Tennessee
Department of Labor and Workforce Development.

- Low inventories of manufactured durable goods continue and should prompt a boost in production in an effort to meet unfilled orders.

- Some early evidence exists of a rebound in manufacturing, and the cyclically-sensitive segments of the industry should continue to report expanded production and employment in 2004.
- The stock market is showing signs of recovery in spite of lingering concerns. The stock-market-induced economic activity in the 1990s was a major factor in the record economic expansion. Clearly, a recovery in market wealth will encourage consumers and investors in 2004.
- The housing industry has been one of the stabilizing factors in the recovery period since 2001. Home sales, durable goods consumption, and construction made real estate the investment of choice for many families and the economic engine for many communities. Next year may see the end of the dramatic gains, but housing should still be strong in 2004.
- Nationally, new home sales are up 12.2 percent for January through October 2003 versus January through October 2002.
- However, a likely increase in interest rates by next spring will probably cause home sales to slow during the year. Profits from construction and home refinancing may be reduced. But, home prices and associated wealth should continue to rise throughout the year.

Table 2. Growth in Real Gross Domestic Product, 2000-2003

Year\Quarter	Q1	Q2	Q3	Q4
2000	2.6%	4.8%	0.6%	1.1%
2001	-0.6%	-1.6%	-0.3%	2.7%
2002	5.0%	1.3%	4.0%	1.4%
2003	1.4%	3.3%	8.2%	Strong

Source: U.S. Bureau of Economic Analysis.

- Improvements in the measures of economic activity shown below present evidence of a sustained recovery in 2004. The Blue Chip Consensus Forecasts of economic activity are developed from submissions by major corporations and universities. Increasing evidence of the strength of the recovery is reflected in the increasingly positive forecasts submitted.

Table 3. Measures of Economic Activity, 1999-2004

	1999	2000	2001	2002	2003 ^F	2004 ^F
Real GDP	4.1	3.8	0.3	2.4	2.7	3.9
Consumer Price Index	2.2	3.4	2.8	1.6	2.3	1.8
Unemployment Rate	4.2	4.0	4.7	5.8	6.1	5.9
Corporate Profits	3.7	-2.2	-7.2	7.6	12.7	11.8
Housing Starts	1.6	1.6	1.6	1.7	1.8	1.7
Ten-Year T-Bill	5.7	6.0	5.0	4.6	4.0	4.8
Personal Consumption Expenditures (Real Dollars)	4.9	4.4	2.5	3.1	3.0	3.5

F=Forecast.

Source: Blue Chip Economic Indicators, October 10, 2003.

- But, lingering international turmoil, continuing terrorist threats, and weak international economies are some of the factors that will limit the strength of the recovery. Of these factors, the downside impact of a terrorist act is the least predictable and potentially the most devastating. For example, the impact of an attack or potential attack on an airline would devastate the tourism, convention, and air travel industries and reverse the direction of the economy in general. An unsuccessful conclusion of current military actions will also weigh heavily on the outlook for the economy in 2004.
- While 2003 looks to have a strong finish, the Sparks Bureau of Business and Economic Research expects economic growth in 2004 to be slightly weaker than the current consensus estimate of 3.9 percent, the increase in inflation to be higher than 1.8 percent, and corporate profits to be lower than the 11.8 percent predicted by other forecasters. Weaknesses in the labor market suggest that the unemployment rate will remain near 6.0 percent. Increases in the Federal Funds Rate in response to strong economic growth and increases in the CPI will drop the housing supply back toward 1.6 million units as mortgage rates rise during the year. But, business investments and consumer spending will provide positive momentum for the economy next year.

II. The Memphis Economy

- Local home sales and prices are still strong on the basis of low mortgage rates.

Table 4. Home Sales in Memphis, 2002-2003

	September Comparisons		
	2002	2003	% Change
Total Home Sales	1,084	1,217	+12.3%
Median Sales Price	\$132,000	\$130,000	- 1.5%
Average Sales Price	\$153,900	\$158,100	+ 2.7%
Year-to-Date Sales	10,280	11,233	+ 9.3%
Year-to-Date Sales Volume	\$1.56 Billion	\$1.73 Billion	+10.9%
Active Listings	7,918	8,462	+ 6.9%

Source: Memphis Area Association of Realtors Multiple Listing Service.

- Local job growth numbers have been weak since the recession started, but some sectors are growing and overall weakness appears to be easing.

Table 5. Memphis MSA Employment, Selected Sectors, October 2002-2003

	Change	% Change
Total Nonfarm Employment	- 1,100	- 0.2%
Education and Health	+2,200	+3.3%
Eating and Drinking Establishments	+1,000	+2.7%
Manufacturing	- 700	- 1.4%
Construction	+ 600	+2.5%

Source: U.S. Bureau of Labor Statistics and Tennessee Department of Labor and Workforce Development.

- Manufacturing losses will continue and result in plant closures throughout Tennessee. Even Memphis with its small manufacturing sector has experienced job losses.

**Table 6. Memphis Metropolitan Statistical Area Economy at a Glance,
April–September 2003**

Labor Force Data (In Thousands, Not Seasonally Adjusted)	May 2003	June 2003	July 2003	Aug. 2003	Sept. 2003	Oct. ^P 2003
Civilian Labor Force	578.7	593.0	588.1	584.5	580.6	585.0
Employment	549.2	555.9	554.3	551.2	548.1	549.7
Unemployment	29.5	37.2	33.8	33.4	32.5	35.3
Unemployment Rate (%)	5.1	6.3	5.7	5.7	5.6	6.0
Nonfarm Wage and Salary Employment (In Thousands, Not Seasonally Adjusted)	May 2003	June 2003	July 2003	Aug. 2003	Sept. 2003	Oct. ^P 2003
Total Nonfarm	582.6	580.7	576.5	581.0	582.6	583.4
12-Month % Change—Total Nonfarm	-0.3	-0.5	-0.8	-0.7	-0.2	-0.2
Natural Resources And Mining	0.1	0.1	0.1	0.1	0.1	0.1
12-Month % Change—NR & Mining	0.0	0.0	0.0	0.0	0.0	0.0
Construction	23.6	24.1	24.3	24.6	24.7	24.8
12-Month % Change—Construction	-3.3	-3.2	-4.0	-2.0	-2.0	2.5
Manufacturing	50.9	50.9	50.7	51.0	51.0	50.7
12-Month % Change—Manufacturing	-1.4	-1.9	-2.7	-2.5	-1.4	-1.4
Trade, Transportation, and Utilities	163.5	163.2	163	162.9	162.8	162.9
12-Month % Change—TTU	-0.8	-1.3	-1.7	-1.3	-1.3	-1.5
Information	9.4	9.3	9.2	9.2	9.2	9.3
12-Month % Change—Information	-3.1	-3.1	0.0	-4.2	-3.2	-1.1
Financial Activities	31.6	31.6	31.3	31.3	31.3	31.3
12-Month % Change—Financial Activities	-1.6	-1.6	-1.6	-1.9	-2.2	-1.9
Professional and Business Services	74.1	74.2	73.9	73.6	74.2	74.0
12-Month % Change—PBS	-0.9	-1.5	-1.6	-1.2	0.1	0.5
Educational & Health Services	68.1	68.1	67.9	68.5	69.3	69.3
12-Month % Change—EHS	3.5	3.8	3.5	3.5	3.3	3.3
Leisure & Hospitality	52.9	54.0	53.4	53.6	51.6	51.4
12-Month % Change—Leisure and Hospitality	1.7	0.4	0.4	-0.2	0.4	0.4
Other Services	22.7	23.0	23.0	22.8	22.6	22.7
12-Month % Change—Other Services	-1.3	-1.3	-0.9	-0.4	0.0	-0.9
Government	85.7	82.2	79.7	83.4	85.8	86.9
12-Month % Change—Government	-0.1	0.5	0.0	-0.2	1.1	-0.6

^P=Preliminary.

Source: U. S. Bureau of Labor Statistics and Tennessee Department of Labor and Workforce Development.

- The data presented below show that while some sectors of the Memphis economy grew in FY 2003, most did not. Growth in collections for the top ten sectors was flat at -0.7 percent but down -4.6 percent across all sectors combined.

Table 7. City of Memphis Top Ten Retail Sales Tax Collections by Sector, FY 2002 to FY 2003

Sector	Sum FY 2002	Sum FY 2003	% Change
Eating and Drinking Places	\$ 17,758,687	\$ 18,122,364	2.0%
Department Stores	17,367,091	16,695,501	-3.9%
Grocery Stores	15,386,124	14,650,188	-4.8%
Lumber and Other Building Materials Dealers	5,563,628	5,649,523	1.5%
Sporting Goods Stores and Bicycle Shops	6,070,367	6,578,033	8.4%
Hotels and Motels	5,108,469	5,235,604	2.5%
Motor Vehicle Dealers (New and Used)	5,172,510	5,078,291	-1.8%
Miscellaneous Retail Stores	4,905,407	4,786,969	-2.4%
Furniture Stores	4,266,059	4,396,679	3.1%
Auto and Home Supply Stores	3,746,657	3,522,008	-6.0%
Sum of Top 10	85,344,999	84,715,160	-0.7%
Grand Total for All Sectors	\$167,942,395	\$160,134,304	-4.6%

Note: Local Option Sales and Use Tax Collections, Accrual Data, July 2002 - June 2003.

Source: Tennessee Department of Revenue.

- At the state level, total tax collections were up 9.24 percent during the first quarter of the state's 2004 fiscal year (July-September) over the same time period last year. Even so, Governor Bredesen has called for 5.0 percent across-the-board reductions in all state departments' budgets. Municipalities should still be wary of potential cuts in state-shared and provided revenue sources.

III. The Tennessee Economy

- A robust economic recovery in 2004 will be good news for the state's economy.
- The job losses in Tennessee appear to be over. After two years of consecutive job losses in 2001 and 2002, Tennessee should end up with positive job growth in 2003. Tennessee should see renewed job growth in 2004.

**Table 8. Tennessee Monthly Average
Total Nonfarm Employment,
January-October 1999-2003**

Year	Monthly Average*	Change	Percent Change
1999	2,675.03	—	—
2000	2,723.93	48.9	- 1.8%
2001	2,689.28	(34.7)	- 1.3%
2002	2,661.89	(27.4)	- 1.0%
2003	2,665.85	4.0	+0.2%

*Thousands.

Source: U.S. Bureau of Labor Statistics.

- Many communities continue to struggle as a result of the weak economy of the last three years.
- Cyclical and structural changes in manufacturing occurred at the same time and devastated many cities and counties across the state.
- While the state has maintained an unemployment rate that is below the nation's, the state's urban areas have been the most prosperous.
- Many rural counties face long-term economic hardship and high rates of structural unemployment. The \$250 million expansion at Nissan and the Toyota motor plant in Jackson will add to the automotive infrastructure in Tennessee.
- While a recovery in rural counties can occur as a result of rising agricultural prices and production, most rural communities are heavily dependent upon the economic vitality of local employers.

- Many potential labor market participants are waiting out the economic hard times and will reappear as the state's economy recovers.
- As a result, it will be difficult to reduce state and local unemployment rates unless employers begin to expand job opportunities for people in Tennessee.
- Job and economic losses in FY 2004 associated with the movement of troops to the Middle East may be offset if the job market improves and the troops return quickly in FY 2005.
- The rising welfare caseload is a direct result of the prolonged economic malaise in Tennessee. Memphis and Shelby County accounted for 24,497 cases in August 2003. This caseload figure exceeded the caseload totals for Davidson County (10,596), Hamilton County (4,434), Knox County (3,991), Madison County (1,709), Montgomery County (1,435), Rutherford County (1,704), and Sumner County (1,150). All other counties in Tennessee had less than 1,000 cases (see Table 9).
- Continuous increases in TennCare expenditures are draining resources away from other sectors of government—particularly higher education.
- The shift to students of the costs for higher education will ultimately impact enrollments and have a long-term negative impact on the future of Tennessee. The start of the lottery should help offset these cost increases, and many of the state's best and brightest students will stay in Tennessee.
- Employment in the education, health services, leisure, and hospitality sectors continues to increase growth of the service sector. Growth in the service sector is associated with shifts in consumption away from goods (taxed) and toward services (non-taxed).
- Foreign investments are likely to remain strong. Tennessee exports should rise as the sales of agricultural commodities, computers, medical instruments, and other products increase as a result of the improved economy.
- Manufacturing losses will continue and result in plant closures throughout Tennessee. Parts of these losses are structural in nature. Manufacturers are looking to increased productivity through technology and lower labor costs in other countries in the ever-constant quest for profitability. Both of

Table 9. Labor Force, Employment, and Unemployment, U.S. and Tennessee

Seasonally Adjusted	Labor Force	Employment	Unemployment	Unemployment Rate (%)		Rate Change (%)
				October	September	
U.S.	146,793,000	138,014,000	8,779,000	6.0	6.1	- 0.1
Tennessee	2,910,600	2,749,200	161,400	5.5	5.4	0.1
Not Seasonally Adjusted	Labor Force	Employment	Unemployment	Unemployment Rate (%)		Rate Change (%)
				October	September	
U.S.	146,788,000	138,619,000	8,169,000	5.6	5.8	- 0.2
Tennessee	2,934,600	2,780,500	154,100	5.3	5.0	0.3

Source: Tennessee Department of Labor and Workforce Development.

these factors necessarily dictate fewer workers needed domestically in manufacturing processes, but particularly on the low-skilled end of the labor force.

- ▶ With time for adaptation, however, technological advances introduced into manufacturing processes will spur manufacturers to search for and hire a better-skilled and educated workforce. And, if the manufacturers cannot find this type of labor in Tennessee, they will import it from outside Tennessee, at best, or simply leave the state, at worst. For Tennessee to be successful, the state must educate its citizens to meet the needs of the Tennessee economy of tomorrow and not just the needs of today.